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The Forest For The Trees: The Need For Tax Incentives To Save & Invest

1. The current economic environment and recent history argue for savings and investment incentives for all taxpayers regardless of income class. "Class warfare" by politicians over who uses a pro-growth tax incentive that accomplishes its objective should be a moot point -- all taxpayers benefit from economic growth stimulated by increased savings and investment.
2. The consequences of protracted and large federal deficits is reflected through the increasing burden of federal debt. Federal debt as a percent of GNP measured 33% in 1980, passed the 50% mark in 1986, and will escalate to an estimated 59% in 1990.
3. Despite current economic conditions, reducing the deficit by a combination of raising taxes and lowering spending may be called for -- given political realities. Large deficits are acting as a drag on the financial markets and the economy. Many individuals have lost complete confidence in the benefits of and limits to government spending. Pro-growth tax incentives are part of the prescription for what ails the economy.
4. The results of a recent SIA/Opinion Research Corporation executive survey support the historical evidence on how critical tax incentives or disincentives are in encouraging or discouraging savings and investment.

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- A reduction in the capital gains tax rate to 20% with a one-year holding period would spur 55% of the surveyed executives to increase investment in common stock, with the mean investment amounting to \$20,800.
 - Seventy percent of the executives said they would open 10-year savings accounts that exempted earnings as they build and when withdrawn. In terms of funds invested in the accounts, 12% of the executives indicated monies would be from shifted savings, 16% said funds would be new savings, and 41% claimed monies saved would be a combination of shifted and new savings.
 - A 50% shareholder credit to alleviate the double tax on dividends would prompt 67% of the executives to make new or increased investment in common stock or common stock mutual funds.
 - A 0.5% tax on the purchase or sale of common stock would cause 45% of the surveyed executives to decrease their stock transactions and 36% to reduce their net investment in common stock.
5. The major conceptual flaw in the various bills is the claim to directly or indirectly increase taxes on the "rich." There are few people that consider themselves rich because their income exceeds \$100,000 or \$200,000. For example, a married professional couple -- doctors, lawyers, consultants -- would hit this income mark.
 6. Today, the income groups over \$50,000 pay a much larger share of the income tax burden than in 1980. More than anything else, this reflects the rapid upward move in income distribution as individuals and families, benefiting from the economic growth of the 1980s, moved into higher income brackets.
 7. High spending, high taxing governments have never provided the environment necessary for sustainable economic growth for their citizens.

Note: The views expressed in this paper are those of the authors and not necessarily SIA.

Single copies of the SIA/ORC study, *Executives' Investment Reactions to Tax Proposals Affecting Savings & Investment*, on which this paper is partly based are available free of charge. Additional copies available for a modest price.

Introduction

In early 1989, the federal government examined the importance of and issues related to national savings and investment, with a strong concern for the dismal U.S. position. Background materials prepared for the Administration's Economic Policy Council in 1989, and recently summarized in the Treasury Bulletin, pointed to three major economic challenges for the U.S. in the future: 1. maintaining a strong economy; 2. competing successfully in the world economy; and 3. preparing for the "demographic twist" when the retirement-age population will outnumber the working-age population. The key to addressing these challenges is improved productivity: a higher rate of national savings is a crucial component of that goal.

The need to bolster savings and investment, while not exactly forgotten, has been put on a back burner recently. This problem deserves more, not less, attention in times of budgetary dilemma, near-recessionary conditions and weak capital markets. The pressure Congress once again feels to reduce the weighty federal deficit seems to preclude consideration of meaningful savings incentives in the tax code. Indeed, the President's capital gains proposal brought the budget process to political gridlock. Either of the two opposing sets of revenue estimates for this proposal indicate a minor impact on the deficit. In the past, capital gains tax reductions have led to revenue increases.

Several changes in policy are needed to ensure stable economic growth, including savings and investment incentives. The current economic environment and recent history argue for savings and investment incentives for all taxpayers with the wherewithal to take advantage of them. If a tax incentive accomplishes its job -- stimulating savings and investment, all other concerns such as which income group uses the incentive should be a moot point. All taxpayers eventually benefit from economic growth and job creation resulting from savings and investment.

Current Economic Environment

Even before the early-August Mideast crisis, there were more than a few signs that economic growth was slumping. In broad terms, real GNP expanded at a 2.5% annual pace in 1989, dipping to a meager 0.3% in the last quarter. Economic growth picked up to a 1.7% annual rate in the first quarter, but plummeted in the second quarter to only 0.4%. Employment growth, reflecting the slowing economy, has fallen to the slowest rate since the 1982 recession. Inflation has gathered momentum during the year and was clocked at a 5.6% annual rate in August. With the Fed keeping an ever-watchful eye on inflationary pressures, interest rates have been firm despite mounting recessionary signals. Moreover, the dollar is having problems in the foreign exchange markets. With major foreign countries raising interest rates, it is questionable just how much room there would be for any easing of rates.

Major sectors of the U.S. economy are depressed. The slump in the real estate industry and the associate housing and construction sectors has intensified in 1990. Housing starts have sunk to the lowest level since the 1981-82 recession and, given

the asset/liabilities problems of the banking industry and stiffer capital requirements, lenders are particularly cautious in extending credit. Chase Manhattan's announcement of 5,000 layoffs is a sad comment to the turmoil of the banking industry. The ills of the savings and loan industry in the past two years have set regulators and legislators on a long and costly path to sort them out. The days of glory of the securities industry were put to an end by the 1987 crash, with over 45,000 employees, or 17.4% of the industry's labor force, laid off since that time. While these sectors have been particularly hard hit, corporate profits have been steadily worsening. Although Iraq may have been the "trigger" calling attention to the state of the economy, many signs were already pointing to a bumpy, not soft, landing ahead.

The stock market has never fully regained investors' confidence since October 1987. Although there have been occasional hints that individual investors were returning to the market, neither individual nor institutional investors have put much "spark" into stock market performance in recent years. While stock market indices have until recently generally climbed slowly, volume levels in 1988 and 1989 were some 12%-14% below the 1987 peak. Volume in 1990 through August was depressed below even the 1988-89 levels. In August, markets twisted and turned to the tune of oil price gyrations, cumulating in a Dow give-up of almost 300 points. By the end of September, the Dow had broken below the 2500 level for a loss of almost 450 points since early August.

Large and small cap stocks moved pretty much in tandem until 1986. Since that time, with the exception of 1988, smaller capitalized companies have not enjoyed the same gains as their bigger brethren nor weathered downturns as well. Much of the focus in the second half of the 1980s was on merger and acquisition activity, with at least part of the \$500 billion in equity retirement in the decade attributed to this activity. These supply factors spurred the price advance of the late 1980s. Nevertheless, after the crash, stock prices took almost two years to reclaim lost territory. The pre-crash Dow record was 2722.42 -- the 1989 close was only 1.1% above this high. Events of the past few months have sent stock prices back to below the 1989 close.

As a reflection of market fundamentals, the initial public offering market, once primarily the domain of new companies and individual investors looking for returns in the form of capital gains, has all but evaporated. Closed-end mutual funds, which invest in fixed income instruments or stocks of foreign countries, have become the major portion of the IPO market. For example, in 1988 and 1989, closed-end funds accounted for 74.4% and 55.1%, respectively, of the funds raised in the IPO market.

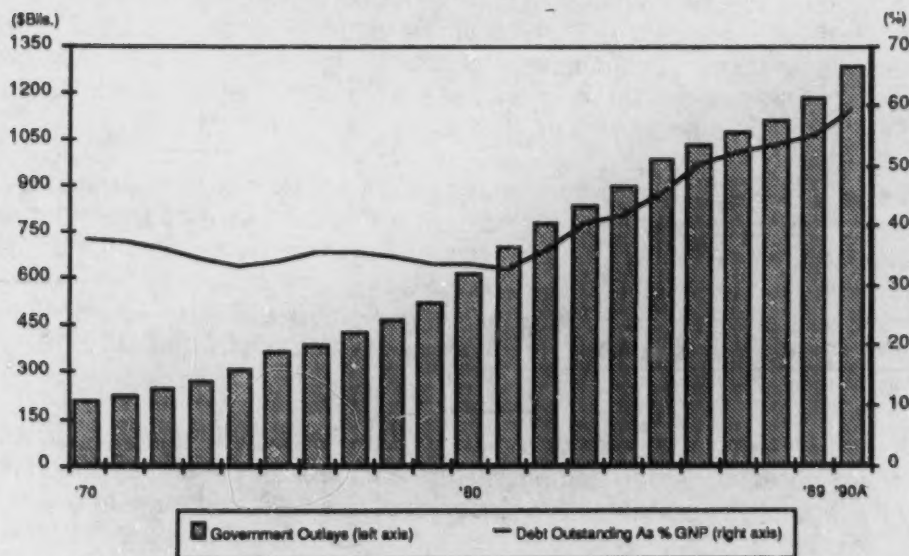
Adding another dimension to the picture is a building worldwide capital shortage. Between 1980-88, the U.S. was able to maintain domestic investment at almost the same level as during the 1950-79 period despite the increasing drain of government on private sector savings. A tremendous surge of foreign capital allowed the U.S. to "overspend" in the 1980s. The foreign capital supply, while probably destined for an end sooner or later, seems to be coming to an end sooner. Whether prompted by opportunities elsewhere or a weakening U.S. economic outlook, foreign investors pulled \$6.8 billion from the U.S. equities market in the first six months of 1990, in contrast to net purchases of \$5.0 billion in the same period in

1989. Combined with the outflow of U.S. investors who are increasingly seeking overseas portfolio diversification, the potential demand for U.S. equities was reduced by some \$13 billion in the first half of the year just by global capital flows. The consequences of a sharp retreat by foreign investors and stepped-up capital outflows by U.S. investors are many, but two are higher real interest rates and lower equity prices in the U.S.

Policy Options

The federal deficit has been stuck at about \$150 billion (on and off budget) for the past three fiscal years. Deficit reduction can be claimed only as a percentage of GNP and only because GNP has grown as real economic growth continued. However, the consequences of protracted deficits is captured in the increasing burden of federal debt. Federal debt as a percent of GNP measured 33.3% in 1980, passed the 50% mark in 1986, and escalated to an estimated 59% in 1990. Although a surplus is expected in the last month of the year which would reduce the total deficit, as of the first 11 months of fiscal 1990, the budget deficit totaled \$241.72 billion, with about \$38 billion attributed to expenses for the Resolution Trust Company (RTC). Spending is 12.8% ahead of last year; minus the RTC funds, spending is up roughly 9.2%. With one exception, total government spending has outpaced inflation in every year of the 1980s. The estimate for the fiscal 1991 deficit is a record \$230 - \$250 billion.

**As Government Spending Continues To Grow
The Federal Debt Spirals Ever Upward**



A budget agreement for fiscal 1991 is no easy task. The economy is fragile, the capital markets have lacked enthusiasm since the crash, the props of U.S. investment in the 1980s are dwindling, and the deficit reduction efforts of past years

(criticized by some as being based on "smoke and mirrors") have borne little fruit. The Mideast crisis exacerbated these factors and limited policy options further.

Traditional economic theory prescribes lower taxes and higher government spending to shake an economy out of the doldrums, particularly when the economy is softening and threatened by recession. Nevertheless, policymakers have sought instead to reduce the deficit by a combination of raising taxes and lowering spending. Despite the current economic scenario, we believe such a strategy may be warranted. Many individuals believe that the deficit and its financing act as a strong fiscal drag on the economy. Moreover, most of the working population has lost confidence in government spending and view reductions in expenditures as a positive factor even in soft economic times, especially if taxes can be kept down.

The appropriate time to have focused on deficit reduction was when the economy was stronger, so that reduced government spending and higher taxes would have been more tolerable to various groups. Nevertheless, we believe deficit reduction will give the financial markets comfort because of the drain of large, protracted deficits. Deficit reduction is particularly timely, given more and more evidence that the U.S. markets in the 1990s will not enjoy the cushion of foreign capital.

Tax rates were lowered in the 1980s, in the early years of the Reagan presidency and later by the Revenue Act of 1986. As an offset to lower rates, the income tax base was broadened. Taxes, as a percentage of adjusted gross income (AGI), declined from about 16% in the early 1980s to about 14% by 1988, indicating that the increase in individual income taxes was not as rapid as the increase in AGI. For example, individual income tax receipts (liabilities) rose from \$256.3 billion to \$433.2 billion in 1988, or 1.7 times. Over the same period, AGI grew from \$1,613.7 billion to \$3,097.3 billion by 1988, or 1.9 times. Thus, AGI rose about 12% faster than individual income taxes. This analysis, of course, ignores significant increases in social security taxes and other taxes such as state and local tax burdens. Few individuals feel their overall tax burden has declined in recent years.

Most of the arguments about reduced progressivity in our tax structure fail to consider that there has been substantial upward movement of taxpayers through the income distribution. Although the very top income classes enjoyed a significant increase in their share of income, so too have they paid a larger share of individual income taxes. For example, the \$100,000+ group accounted for 15.3% of income taxes in 1980 and 35.6% in 1988 as their tax liabilities rose from \$39.2 billion to \$154.3 billion.

All of the income classes above \$50,000 saw their increase in income taxes lag their income increase. At the same time, the decrease in the share of income tax paid by the under \$50,000 income classes exceeds their decrease in share of income. In other words, the average tax rate for all income classes declined from 1980-88. Admittedly, the decrease was greatest for the top income classes -- exactly the purpose of the pro-growth income tax reductions of the 1980s.

Tax policy attempted to foster economic growth and job participation -- and it worked. Given the effectiveness of earlier policies, some policymakers are now

criticizing the reduction in progressivity of the income tax structure. However, "class warfare" makes little sense for a country needing both economic growth and additional savings and investment.

One of the main stumbling blocks to restoring tax incentives has been the question of the distribution of income. The "soak the rich" mentality -- with the "rich" redefined in income terms for the IRA and capital gains debate -- is an extremely narrow one. If those with the discretionary funds to save and invest respond positively to tax incentives to do so, the focus of policymakers should be on the benefits that savings and investment provide -- economic growth and jobs. Clearly, economic incentives are part of the prescription for what ails the economy.

Some argue that, given the slide of the personal savings rate in the 1980s, savings and investment incentives such as the IRA and lower capital gains taxes were not effective. However, savings behavior is influenced by many factors and some researchers have concluded that without these policies, the savings rate would have been even lower.

Late last year, SIA undertook a survey of executives with Opinion Research Corporation (ORC) to determine their response to tax proposals affecting savings and investment. While the survey responses cannot be extrapolated to the entire population, the responses indicate how individuals who make frequent investment decisions and have discretionary income would respond to tax policy changes. The results of the SIA/ORC survey are summarized on the following pages. We believe these results support the historical evidence about how critical tax incentives or disincentives are in encouraging or discouraging savings and investment.

Reduction in the Capital Gains Tax Rate

The 1986 tax act contained the largest increase in capital gains taxes in history; a 65% increase for investors in the top tax bracket and an even greater increase for some middle income investors. Prior to 1987, the taxation of inflationary gains and the capital loss limitation were mitigated by the capital gains exclusion. Elimination of the exclusion increased the bias against long-term equity investment.

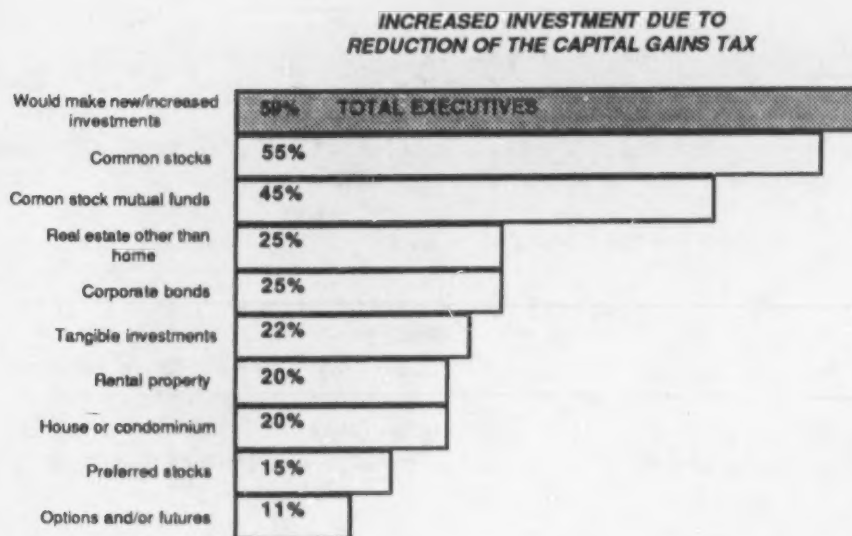
The current return from equity investment, dividends, is subject to both a corporate and individual tax. A capital gain on that same investment, to the extent the gain stems from the reinvestment of corporate income, is also taxed twice. In addition, the limitation on capital losses is both asymmetrical and inequitable. Although net capital gains are taxed as ordinary income, investors suffering *net* capital losses remain limited to only \$3,000 in deductions against ordinary income annually.

One of the key positions taken by opponents of lower capital gains taxes is that the investor has the benefit of deferring tax on gains until realized. Several articles published recently in the Wall Street Journal walked through the exercise of determining the real return to investors on several different types of investment. For example, \$1 invested in the stock market in 1970 would have grown to \$8.90 by the end of 1989. However, deducting transaction and management costs, income taxes

on dividends (calculated at a 28% rate for each year), capital gains taxes, and inflation leaves the investor with \$1.63.^{1/} A dollar invested in fixed income produced even lower returns. These returns are hardly an incentive for risk taking. Another author contends that the capital gain tax environment -- with an effective capital gains rate of 75% for a portfolio purchased in 1975 and sold today -- destroys the incentive to make new risk investments while imposing a prohibitive cost on cashing in mature investments.^{2/}

But, revenue consequences aside for the moment, the major controversy surrounding a capital gains cut in today's debate is who benefits. There are both direct and indirect beneficiaries of lower capital gains taxes. Indirect benefits from equity investment flow to the economy through expansion. Direct benefits -- capital gains realizations -- are enjoyed by a wide strata of Americans. It is estimated that nearly one half of all taxpayers report capital gains during their lifetime. A study by the Joint Tax Committee found that in the 5-year period 1979-83, 44% of taxpayers realized gain in one of those five years. On the other end of the spectrum, 16% of taxpayers realized gains in each year.

A reduction in the capital gains tax rate to 20% with a one-year holding period would spur 55% of the executives in the SIA/ORC survey to increase investment in common stock, with the mean investment amounting to \$20,800. Common stock mutual funds would also benefit as 45% of the executives said they would respond positively. Of the nine investment vehicle choices, common stock and common stock mutual funds were the first and second selection of executives for increased investment.



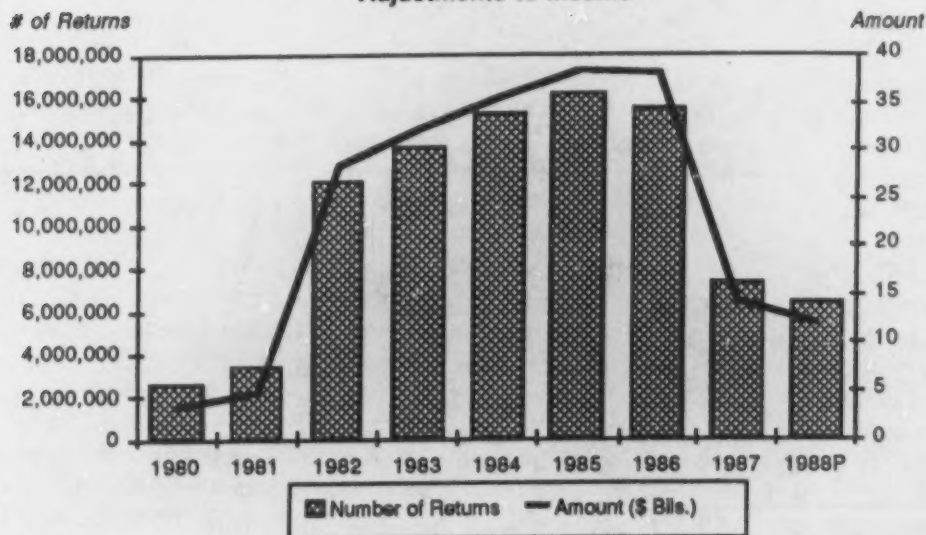
^{1/} "How Taxes and Costs Prey on Nest Eggs," Wall Street Journal, September 25, 1990.

^{2/} "The Real Capital Gains Rate -- 75%," Wall Street Journal, September 17, 1990.

Individual Retirement Accounts/Family Savings Plan

With its "up front" tax deduction and tax-free-until-withdrawn accumulation of earnings, the Individual Retirement Account (IRA) proved an extremely popular savings incentive. The 1981 tax act expanded IRA eligibility because of congressional concerns about the level of savings generally and the desire to provide a discretionary retirement vehicle for all taxpayers. In 1982, contributions to IRAs were claimed on 12 million returns attracting about \$28.3 billion in savings. In peak year 1985, IRA contributions of \$38.2 billion were claimed on 16.2 million returns. The 1986 tax act curtailed the tax deductibility of IRAs for most individuals. By 1988, with the restrictions of the IRA tax deduction, the number of returns claiming IRA contributions dwindled to 11.9 million and the amount of IRA savings, to \$6.4 billion. Clearly, since the loss of the IRA tax deductibility, IRA participation has dropped sharply.

INDIVIDUAL RETIREMENT ARRANGEMENTS
Adjustments to Income



The link between IRAs, other savings incentives, and aggregate savings is still being questioned. However, studies by Professors Venti and Wise of the National Bureau of Economic Research show that IRAs provided a powerful savings incentive.^{3/} Among their findings was that one-half of all IRA deposits represent new savings, while about 30% comes from the taxes individuals save by making IRA contributions. Only 20% of deposits were funds shifted from other savings, given the penalty for early IRA withdrawal.

^{3/} "The Evidence on IRAs", Steven A. Venti and David A. Wise, *Tax Notes*, January 25, 1988.

Moreover, relating to who benefits, Venti and Wise found that 90% of individual contributions and 70% of contributions from families were from those earning less than \$50,000 annually. The professors concluded that expanding the IRA contribution ceiling would generate significant new savings: about two-thirds of increased IRA deposits would represent new savings, with most of the balance being taxes individuals save through IRA contributions.

Professors Feenberg and Skinner developed additional evidence on the net savings effects of IRAs.^{4/} The professors used reported taxable interest and dividends as a proxy for non-IRA savings to test the hypothesis that the returns from non-IRA savings would be reduced if IRA depositors shifted savings. Their research found that from 1981 to 1984, the taxable interest and dividends of IRA depositors increased and rose by *more* than for non-IRA depositors. Hence, new IRA deposits were not shifted from other savings but represented new savings.

The work of Feenberg and Skinner as well as Professor Summers of Harvard also concluded that there was a positive psychological effect on savers due to the IRA advertising campaigns of banks, brokers, etc. The evidence suggests that the massive advertising undertaken for IRA accounts heightened public awareness of the need to save.

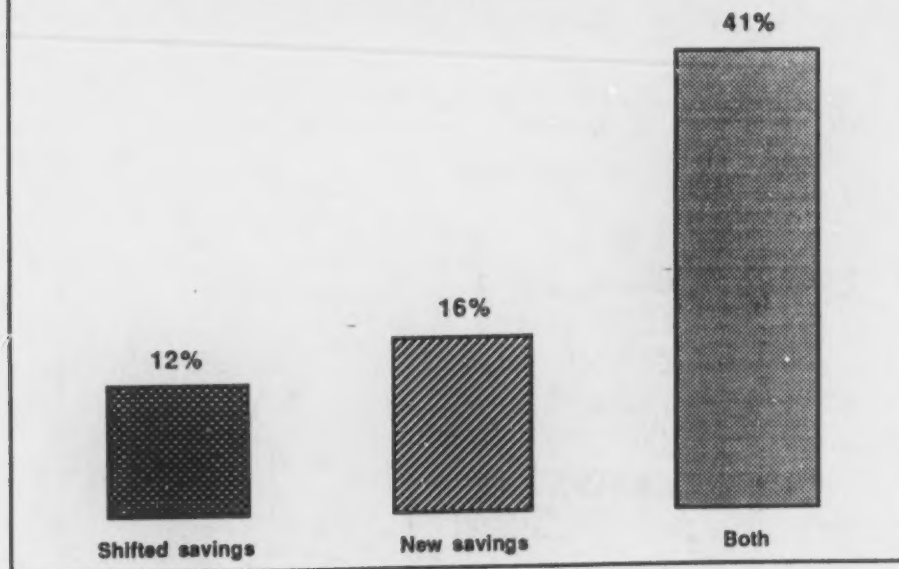
Proposals to once again expand the availability of IRAs have been made, but most would not restore the "up front" tax deductibility of these savings vehicles because of revenue considerations. Some proposals, while more generous than current law, would nevertheless limit availability by income. Indeed, even the availability of the Family Savings Plan would be restricted by income.

The SIA/ORC survey found that executives would be most responsive to an IRA-type savings plan. Based on an early version of the Administration's Family Savings Plan, executives were surveyed as to their response to a 10-year savings vehicle exempting earnings as they build and when funds are withdrawn. Contributions would be limited to \$5,000 annually with a penalty on early withdrawals.

Seventy percent of the executives said they would open these new savings account. As to the source of funds for this new 10-year account, 12% indicated the funds would represent shifted savings, 16% said the funds would be new savings, and 41% claimed monies saved would be a combination of shifted and new savings. Of those responding positively to the savings plan, 41% preferred an immediate tax deduction and 28% preferred the tax exemption of accruing earnings. This IRA-type proposal drew the strongest support from younger executives.

^{4/} *Sources of IRA Savings*, Daniel Feenberg and Jonathan Skinner, National Bureau of Economic Research, October 1988.

**SOURCES OF SAVINGS OF THE 70% OF
TOTAL EXECUTIVES OPENING A LONG-TERM ACCOUNT**



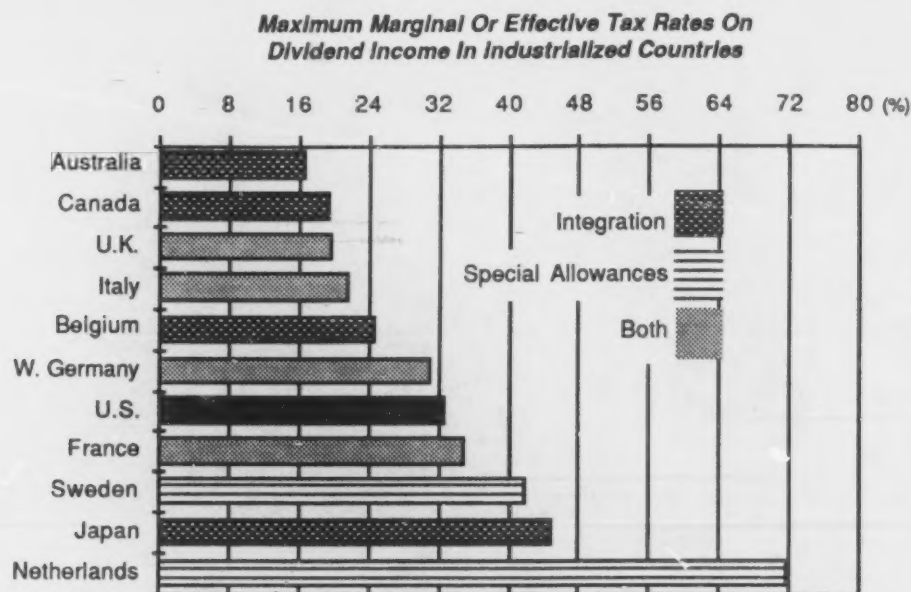
Double Taxation of Corporate Earnings

The M&A buyout craze of the 1980s highlighted the long-standing debt bias in the tax code. The anti-savings slant, or debt bias, is most apparent in the disparate treatment of corporate debt and equity. While interest payments are fully deductible by corporations, dividends are distributed out of taxable earnings and are taxed again to shareholders. Both debt and equity play a role in corporate finance, but there is no logical reason for the tax code to discriminate against either.

The issue of the 100% deductibility of corporate interest paid and the double tax on dividends has gone untouched despite recent revampings of the tax code. Corporate dividends paid to shareholders are subject to a maximum 56% effective tax rate (34% on earnings at the corporate level and 33% on the after-tax amount received as dividends by some shareholders).^{5/} On the other hand, interest payments are deductible by the corporation and payments to taxable entities are subject to a tax of 34% and to individuals, 33%. Indeed, even though tax reform lowered individual and corporate tax rates, there remains a substantial tax discrepancy between the treatment of dividend and interest payments. A dollar of interest paid costs a corporation 66¢ in after-tax terms, whereas a corporation has to earn \$1.34 to pay a dollar of dividends.

^{5/} $.34 + (.66 (.33)) = .34 + .22 = .56$

Most industrialized countries have some form of integration of corporate and individual taxes to mitigate the double tax burden. A 1989 survey of 10 major foreign countries by SIA/Spicer & Oppenheim found that eight have adopted some type of integration.^{6/} For six of these eight countries, integration produces effective tax rates below the maximum marginal U.S. tax rate on dividend income, ranging from 16.8% in Australia to 31.3% in West Germany.



The congressional hearings on LBOs early in 1989 touched on the double taxation of dividend income. Both Federal Reserve Chairman Greenspan and Secretary of Treasury Brady commented that there is a clear need for dividend taxation relief, but revenue considerations limit that relief. Treasury is currently preparing a study on the corporate tax structure, including a discussion of the double tax problem but reportedly with no recommendations for policy change. However, proposals have been made which would take a first step in balancing the tax treatment of debt and equity. Representative Bill Gradison, with analysis from the Joint Committee on Taxation proposed an 80% deduction for both interest and dividends on the premiss that this proposal would equalize the treatment of capital without affecting tax revenues and, hence, the deficit.^{7/}

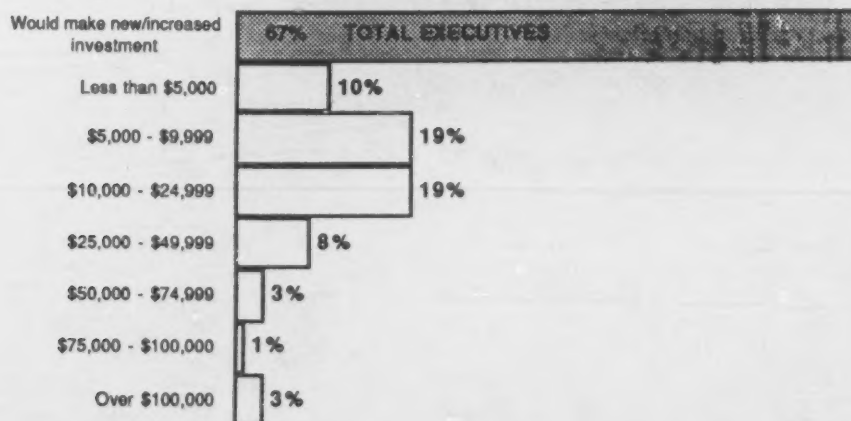
^{6/} *International Tax Comparisons*, SIA/Spicer & Oppenheim, 1989.

^{7/} Stated alternatively, the ratio of corporate dividend payments to corporate interest expense is about 1 to 4. The revenue increase resulting from a 20% disallowance of the deduction for interest paid would be equal to the revenue decrease resulting from an 80% dividend paid deduction.

A dividends paid deduction coupled with a smaller interest paid disallowance may be a starting point for tilting the tax code away from a debt bias. For the corporation, a partial deduction for dividends paid lowers the tax burden on dividends and makes equity financing cheaper. In contrast, disallowing a portion of the interest paid as a corporate deduction makes debt financing more expensive. For the individual, there should be more of an incentive for equity investment in that dividends will not be subject to the full corporate tax and, other things constant, such distributions would increase. In other words, the return on equity investment would be enhanced.

The SIA/ORC survey questioned executives as to a form of integration that would give shareholders a partial credit, 50%, for federal income taxes paid by the dividend-paying corporation. Responding to this proposal, 67% of the executives say they would make new or increased investments in common stock or common stock mutual funds. The mean investment for these executives was \$22,700.

**CHANGES IN COMMON STOCK AND
COMMON STOCK MUTUAL FUND INVESTMENT
DUE TO RELIEF OF DOUBLE TAXATION OF DIVIDENDS**



Corporate America has been perceived as opposing tax integration because of the threat of increased shareholder pressure to pay out dividends. Surveyed executives of publicly-owned companies (82% of sample) were asked if they believed their corporation would favor dividend relief at the shareholder or corporate level. The response was overwhelmingly positive. Seventy-nine percent of the executives believe their corporate employer would favor dividend relief at the shareholder level and 84% believe their company would favor relief at the corporate level.

Tax on the Purchase and Sale of Stock

The securities transaction excise tax (STET) has been considered as a tax option by policymakers from time to time. In recent years, congressional concerns

over market volatility and the perceived short-term focus of corporate management gave momentum to this tax proposal. Notably, the STET was under serious consideration by the Administration in the crafting of the 1991 fiscal year budget package.

Many organizations, including SIA, and individuals weighed in with analysis of the impact a STET would have on investors, markets, and the economy. SIA's analysis noted the STET is one of the poorest tax policy options as it impacts savings channeled to our capital markets.^{8/} Rather than being a progressive tax which falls on the wealthy, a STET would erode the savings and retirement funds of millions of pensioners and mutual fund shareholders. While eroding individuals' savings, the STET would increase the cost of capital for U.S. corporations. The U.S. already fares poorly in terms of capital costs when compared with its major international competitors. Moreover, of 15 industrial countries surveyed, five have either lowered the rates of such taxes recently or are in the process of phasing out the tax completely. Six countries do not have the tax, while four see no threat to their capital markets from global pressures.

With good reason, the STET was not included in the budget summit agreement. Since the STET was first considered, the Mideast crisis and increasing evidence of a sluggish economy have taken their toll on the market. Several analysis concluded that the STET would have a further dampening effect on market volume and prices as well as economic growth.

TAX ON PURCHASE & SALE OF STOCK

45% of Total Executives Would Decrease Transactions	% Decrease	36% of Total Executives Would Reduce Net Investment
3%	Under 5%	2%
6%	5%-9%	5%
11%	10%-19%	7%
10%	20%-29%	11%
16%	30%-100%	11%

The SIA/ORC survey polled executives as to their reaction to a 0.5% tax on the value of the purchases or sale of common stock. Forty-five percent of the executives indicated that they would decrease their stock transactions if this tax were implemented. Among those who would do so, the average decrease in stock transactions was 27.5%. Thirty-six percent of executives also indicated that they

^{8/} See "Securities Transaction Excise Tax: Wrong Tax, Wrong Time, Wrong Place," *Trends*, SIA, August 22, 1990.

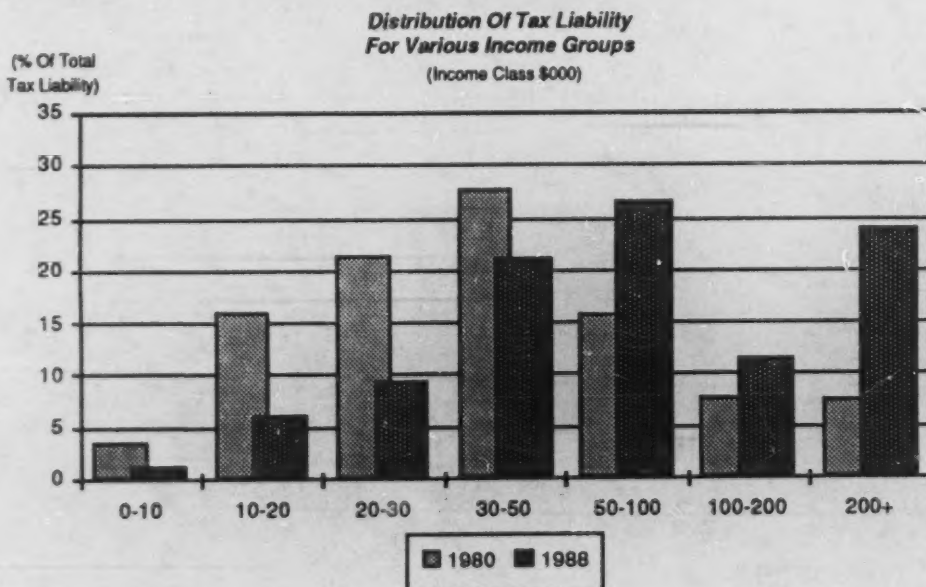
would reduce their net investment in common stock, with the average reduction about 26%. Some 53% of the executives would shift their investment from common stock to other investments. All told, the reactions of executives in the SIA/ORC survey supported the projected negative impact of a STET as indicated by several studies.

Conclusion

Deficit reduction and pro-growth tax incentives are necessary to get the economy back on a long-term growth track. Recently, both political parties are stressing politics rather than economic fundamentals. In other words, class warfare has become as important as deficit reduction.

The major conceptual flaw in the various tax bills is the claim to directly or indirectly increase taxes on the "rich." There are few people that consider themselves rich simply because their income exceeds \$100,000 or \$200,000. For example, it doesn't take much for a married professional couple -- doctors, lawyers, consultants, etc. -- to reach these income levels. Nothing is said in these tax bills about wealth -- the traditional measure of affluence. Rather, the proposed tax bills, like others before, strike at the same group as earlier tax increases, the high income working families.

Political infighting over which class bears the tax burden is obscuring consideration of policies proved effective in stimulating the economy. European history is full of lessons about the results of class warfare. Today, the income groups \$50,000+ pay a much larger share of the income tax burden than was the case in 1980. This group is also a much larger percentage of taxpayers today (12.7% in 1988) than in 1980 (3.3%). More than anything else, this reflects the rapid upward move in income distribution throughout the 1980s as individuals and families moved into higher brackets, a desirable result of economic growth.



The year 1990 seems to have brought the holiday of the 1980s to an abrupt end. The last thing needed now is fiscal policy based on class warfare. It takes tough and confident leadership to make the hard choices to provide for a growing, stable economy. High spending, high taxing governments have never provided the environment necessary for sustainable economic growth. We believe Congress and the Administration should choose pro-growth policies over income redistribution because in the longer run we will be left with an economy more able to provide for all. It would be a Pyrrhic victory, indeed, if economic growth were stunted because of class warfare.

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VOLUME

	SEP. 1990	YTD 1990	SEP. 1989	YTD 1989	% CHG YTD 1990-1989
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	141.3	156.8	151.8	166.1	-5.6%
AMEX (MILS.)*	11.7	13.8	12.6	12.2	13.1%
NASDAQ (MILS.)*	110.3	136.0	131.3	132.5	2.6%
REGIONAL EXCHANGE (MILS.)*	20.9	24.7	24.5	26.5	-6.8%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	\$82,787	\$1,026,714	\$120,174	\$1,165,773	-11.9%
AMEX (MILS.)	2,562	30,218	3,977	32,295	-6.4%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	7,530	89,522	9,255	88,771	0.8%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	10,932	128,776	15,336	155,630	-17.3%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	48.4%	49.7%	49.0%	51.6%	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	9,777	98,191	9,688	97,368	0.8%
AMEX OPTIONS	2,742	26,887	3,740	31,033	-13.4%
COMMODITY	20,488	210,647	19,888	204,497	3.0%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

PRICES
(END OF MONTH)

DOW JONES INDUSTRIALS
STANDARD & POOR'S 500
NYSE COMPOSITE
AMEX MARKET VALUE INDEX
VALUE LINE COMPOSITE
NASDAQ COMPOSITE

SEP. 1990	SEP. 1989	% CHG SEP. 1990-1989
2452.48	2692.82	-8.9%
306.05	349.15	-12.3%
167.85	193.97	-13.5%
307.72	388.76	-20.8%
189.75	275.26	-31.1%
344.51	472.92	-27.2%

YIELDS
(MONTHLY AVERAGES)

BOND BUYER INDEX (20 BOND)
CORPORATE BOND YIELDS (MOODY'S)
Aaa CORPORATE
Baa CORPORATE
RATIO Aaa CORPS. TO Baa CORPS.

SEP. 1990	SEP. 1989	BASIS POINT CHG 1990-1989
7.53%	7.26%	27
9.56	9.01	55
10.64	9.91	73
0.90	0.91	(1)

3

UNDERWRITING

	9 MOS. 1990	9 MOS. 1989	% CHANGE 1990-1989
CORPORATE FINANCING (Gross New Issues - \$ Mils)			
TOTAL	\$237,383.5	\$214,723.1	10.6%
Common Stock	\$16,182.9	\$15,002.1	7.9%
# of Common Stock Issues	336	308	9.1%
Preferred Stock	\$3,610.3	\$5,778.2	-37.5%
# of Preferred Stock Issues	66	75	-12.0%
Corporate Debt	\$217,590.3	\$193,942.8	12.2%
# of Corporate Debt Issues	956	1,056	-9.5%
MUNICIPAL FINANCING (Gross New Issues - \$ Mils)			
Negotiated	\$68,421.1	\$64,783.5	5.6%
# of Issues	3,022	3,785	-20.2%
Competitive	\$22,675.9	\$21,906.3	3.5%
# of Issues	2,555	2,602	-1.8%

Source: Securities Data Co.

RECENT INTERESTING READING AND STATISTICAL MATERIAL

<u>Item</u>	<u>Description</u>	<u>Source</u>
<u>SIA Fact Book -- The Securities Industry of the Eighties</u>	Fact Book designed to provide a decade of data on the most frequently asked questions on the securities industry and capital markets. In 31 pages of tables and charts, the book covers various aspects of the securities industry including: the brokerage community, capital markets, stock market activity, mutual funds, futures and options, retail and institutional trading and holdings, economic data and vital foreign market statistics.	SIA Research Department Members: \$25; Others: \$50
<u>Report on Office Salaries</u>	SIA's annual report presents data on 79 non-exempt positions in 57 SIA member firms employing over 132,500 individuals. Job categories include secretarial, sales assistant, administrative, clerical and operations positions. Among other data, this 218-page report contains tables illustrating weekly office salaries of 1990 compared with 1989 levels to illustrate percentage changes.	Pamela Faber Surveys Manager Members: \$450 to \$675 Others: \$1,400 first copy, \$50 additional copies
"Corporate Finance - Third Quarter Rankings"	The crisis in the Middle East, lingering recession fears, and woes in the banking system put a damper on debt and equity issuance in the third quarter. But, for the 9 months of 1990, overall volume rose on strength in the mortgage- and asset-backed arenas. As a result of a 26.5% jump in MBS issues and a dramatic 207% rise in the in ABS over 3rd quarter volumes in 1989, new issue volume for the first 9 months of 1990 was up 9.3% to \$237.4 billion from \$217.1 billion. Manager ranking data for domestic and foreign issues.	<u>Investment Dealers'</u> <u>Digest</u> October 8, 1990
<u>Indexing Capital Gains</u>	This study considers the advantages and disadvantages of one option for reducing the tax burden on capital gains -- indexing gains for inflation -- as compared with the options of excluding some part of capital gains from taxation or continuing the treatment of capital gains under present law. Topics discussed include: how indexing and exclusion affect different kinds of capital gains assets, distributional effects, and factors affecting revenue under indexing as compared with 30% exclusion. Study makes no recommendations.	Congressional Budget Office

<u>Item</u>	<u>Description</u>	<u>Source</u>
<u>How We Stack Up</u>	Booklet designed as a handy reference tool demonstrating the impact of state fiscal policy on the New York economy. The 31-page booklet is divided into 2 main sections, economic indicators and taxes and spending, and shows New York's standing versus the other states. For example, New York ranks second in a comparison of total state and local tax burden per capita.	The Public Policy Institute of New York State, Inc. 152 Washington Ave. Albany, N.Y. 12210 \$2.50 per copy
<u>Electronic Bulls & Bears: U.S. Securities Markets & Information Technology</u>	This report assesses the current use of information technology by U.S. securities exchanges and OTC dealers, by related futures and options markets, and by associated industries and regulatory agencies. While finding that the U.S. markets are the most efficient in the world, report concludes there are still serious problems to contend with in the future. Some of these problems result from the reluctance to accept technologies that may threaten traditional roles.	Office of Technology Assessment Superintendent of Documents U.S. Government Printing Office \$10
"The curse of checks and balances"	The <u>Economist</u> looks at the recent budget process in the U.S. Rejecting constitutional or party reform, authors find forcing Congress to be more responsible about spending as an easier solution. Incentives to force this turn of events include: linking a Congressmen's pay to the size of the deficit in the previous year -- the bigger the deficit, the lower their pay.	<u>Economist</u> October 13, 1990
"1990 All-America Research Team"	Annual selection of brokerage analysts who have done superior work during the past year ranks 462 analysts from 34 firms. In terms of total team positions, Shearson Lehman took the number 1 spot from Merrill Lynch; Goldman Sachs held on to the number 2 position; and Merrill Lynch dropped to number 3 from last year's top place.	<u>Institutional Investor</u> October 1990